



STATE BOARD OF EQUALIZATION

LEGAL DEPARTMENT (MIC:82)
 450 N STREET, SACRAMENTO, CALIFORNIA
 PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
 TELEPHONE (916) 324-2056
 FAX (916) 323-3387
www.boe.ca.gov

CAROLE MIGDEN
 First District, San Francisco

BILL LEONARD
 Second District, Ontario

CLAUDE PARRISH
 Third District, Long Beach

JOHN CHIANG
 Fourth District, Los Angeles

STEVE WESTLY
 State Controller, Sacramento

RAMON J. HIRSIG
 Executive Director

October 1, 2004

Re: Revenue and Taxation Code Section 63.1 - Parent-Child Exclusion

Dear Mr. :

This is in response to your letter dated June 1, 2004, requesting the Board of Equalization's understanding of the operation of the parent-child exclusion pursuant to Revenue and Taxation Code section 63.1¹ (Proposition 58). You stated that your focus is on the value for assessment purposes both before death and after death of the transferor, giving consideration to the exclusion amount of \$1 million in full cash value from each parent. You have set forth several examples that are restated below followed by our responses.

Law and Analysis

As you know, Proposition 58 added subdivision (h) to section 2 of Article XIII A of the California Constitution. Briefly, subdivision (h) provides that the terms "purchased" and "change in ownership" exclude the purchase or transfer of (1) the principal residence between parents and their children, and (2) the first \$1 million of the full cash value of all real property other than a principal residence between parents and children. Section 63.1 was added to the Revenue and Taxation Code to implement the parent-child exclusion provisions of Proposition 58. To qualify for this exclusion, the purchase or transfer must be from an eligible transferor to an eligible transferee and qualify in each case under the implementing provisions of section 63.1.

Property Tax Rule 460, subsection (b)(1) defines the term "Base Year" as:

The assessment year 1975-76 serves as the original base year. Thereafter, any assessment year in which real property, or a portion thereof, is purchased, is newly constructed, or changes ownership shall become the base year used in determining the full value for such real property, or a portion thereof.

¹ All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

“Base year value” also means its full cash value, as determined in accordance with Section 110.1, with the adjustments permitted by subdivision (b) of Section 2 of Article XIII A of the California Constitution. Pursuant to section 63.1, subdivision (c)(5) “Full Cash Value” means - Full cash value is defined by section 110.1 and section 2 of Article XIII A of the California Constitution just prior to the date of transfer; basically the taxable value on the roll immediately prior to the date of transfer to an eligible transferee.

Two Points of Clarification

First, we note that you are interchangeably using the words exclusion and exemption. An exemption is defined as “immunity; something exempted, esp. from taxation.”² Property exempt from property taxation is listed in section 3 of Article XIII A of the California Constitution and property eligible for exemption is listed in section 4 of Article XIII A. Proposition 58 is not among the exemption items listed because it is an exclusion from change in ownership³ reassessment. Exclusion is defined as “to omit from notice or consideration: Disregard.”⁴ Thus, Proposition 58 excludes certain transfers of changes in ownership subject to reappraisal, but does not “exempt” the transferred property from taxation.

Finally, although you use the term “assessed value”, we assume that you mean base year value or adjusted base year value and that the \$1 million value limitation (for property other than the principal residence) is separately applicable to each eligible transferor. Under section 63.1, subdivision (b)(2), each eligible transferor (parent) may transfer \$1 million to eligible transferees, in addition to a principal resident.

Example 1:

(A) Mrs. Jones dies owning property (other than her principal residence) that has a base year value of \$1 million. The property transfers to her son. At the time of her death that property is worth exactly \$1 million. The question arises as to whether the \$1 million exclusion reduces the base year value to zero.

Response: **No**, Proposition 58 is an exclusion from change in ownership, not an exemption from property taxes. The Proposition 58 exclusion allows the eligible transferee to retain the transferor’s adjusted base year value.

(B) Mrs. Jones buys property for \$1 million. Three days later she dies. The property then passes to her son. The property at that time has a value of \$1 million. What is the base year value assuming that the son elects to take advantage of the \$1 million parent-child exclusion? What is the base year value if the child does not elect to make use of this exclusion?

Response: If the assessor established a based year value of \$1 million when Mrs. Jones acquired the property, and the son files a parent-child claim and the exclusion is granted, his base year value would be the same base year value on the roll, \$1 million. If he does not file a claim, it is

² WEBSTER’S II NEW COLLEGE DICTIONARY 393 (2001).

³ Revenue and Taxation Code section 60 provides “A “change in ownership” means a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.”

⁴ WEBSTER’S II NEW COLLEGE DICTIONARY 391 (2001).

likely that his base year value would remain the same, \$1 million, because the fair market value has very likely not changed over the three day period between the change in ownership when Mrs. Jones acquired the property and the change in ownership on the date she died. In this situation, the son would not benefit by filing a claim, because there is no change in value at the date of transfer.

Example 2:

The facts are similar to the above except for the following: the base year value of the mother's property is \$500,000. Its value when transferred to her son at the time of her death is now \$1 million. What is the base year value as to the son if he elects the parent-child exclusion? What is the base year value if he does not make that election?

Response: Proposition 58 exclusion is limited to the first \$1 million of real property from each eligible transferor, other than the principal residence. Thus, if the son files a parent-child claim and the exclusion is granted, the transfer would be excluded from change in ownership, and the base year value of the property would be \$500,000, the taxable value on the roll. If he chooses not to file a claim, then the property will undergo a change in ownership and be reappraised at the current fair market value, \$1 million.

Example 3:

Mother owns property she bought for \$1 million. Three years later she dies and the property, now worth \$2 million, passes to her son. What is the base year value to the son if he makes the parent-child election? What is the base year value if he does not?

Response: The \$1 million limit applies to adjusted base year values, not current fair market values. If adjusted base year value is \$1 million plus 3 years of inflation adjustments under section 51, subdivision (a)(1)(D), then the parent-child claim excludes the \$1 million plus the adjustments for inflation. If he doesn't claim an exclusion, then the new base year value is \$2 million.

Proposition 58 is an exclusion from change in ownership; thus, any property granted this exclusion within the \$1 million limitation is not reassessed or subject to a supplemental assessment. This means that if the value of the property transferred exceeds the exclusion limit, then any excess (\$1 million in this example) would be subject to supplemental assessment.

Example 4:

Mother owns property but this time its base year value is \$2 million. At the time of her death the current fair market value is \$3 million. The property passes to her child. What is the base year value for assessing property taxes if the child elects to make use of the \$1 million exclusion? What is the base year value if the child does not?

Response: If the son files a parent-child claim and the exclusion is granted, the base year value is \$2.5 million. (See Letter to Assessor's No. 87/72, dated September 11, 1987, *attached*.)

Calculation is as follows:

1. Determine Nonexcluded Portion of Taxable Value.

Total Taxable Value:	\$2 million
Less: Exclusion	<u>-1 million</u>
Nonexcluded Portion:	<u>\$1 million</u>

2. Determine the Percentage of the Nonexcluded Portion to be Applied to Current Market Value (CMV).

$$\text{Nonexcluded Portion/Taxable Value} = \$1 \text{ million}/\$2 \text{ million} = 50\%$$

3. Determine the Current Fair Market Value (FMV) of the Nonexcluded Portion of the Property.

$$\text{Current FMV} \times 50\% = \$3 \text{ million} \times 50\% = \$1.5 \text{ million}$$

4. Determine the New Base Year Value.

Exclusion	\$ 1 million
Current FMV of Nonexcluded Portion	<u>1.5 million</u>
New Base Year Value	<u>\$ 2.5 million</u>

If he chooses not to file a claim, the entire \$3 million is subject to reappraisal as a change in ownership. See also additional examples in the attached Letter to Assessors, No. 98/23.

Example 5:

This time the base year value is \$2 million but the current fair market value at the time of death is only \$1 million. What is the base year value for the child who receives that property assuming he does not make use of the parent-child exclusion? What is the value if he does use the exclusion?

Response: If he chooses not to file a claim, then the property will undergo a change in ownership, and a new base year value of \$1 million will be established. If the son files a parent-child claim and the exclusion is granted, \$1 million would be excluded from change in ownership, and the new base year value on the other 50 percent would be \$500,000.

October 1, 2004

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

/s/ Shirley Johnson

Shirley Johnson
Tax Counsel

SJJ:jlh
Precedent/Parchild/04/011sjj.doc

Attachment – Letter To Assessors No. 87/72, and No. 98/23

cc: Mr. David Gau, MIC: 63
Mr. Dean Kinnee, MIC: 64
Ms. Glenna Schultz, MIC: 64
Ms. Mickie Stuckey, MIC: 62
Mr. Todd Gilman, MIC: 70